Crisis Investing

Owner's Manual

"You want to be greedy when others are fearful and fearful when others are greedy."

—Warren Buffett

What is the greatest secret in all of investing?

What really separates amateurs from professionals? Losers from winners?

If you search the Internet, you'll find dozens of people with dozens of answers to this question. Some will say the secret is their proprietary trading system. Some will say it's their method of picking stocks.

I'm sure some of those ideas are useful. But they're not nearly as useful as something I call "the most powerful wealth-building secret in investing."

Master this skill and you'll consistently spot opportunities to make five or ten times your money on **safe** investments.

I know that's counter to the conventional investment wisdom that says you have to take big risks to make big returns.

Well, after learning this secret, you'll know that you most certainly do not have to take big risks to make big returns. You'll know most people have it backwards. You simply have to know how to apply this one skill.

It's a skill that made Sir John Templeton a rich man and one of the most respected investors of all time. A skill that helped make Warren Buffett one of the richest men in the world. And it's a skill that helped make Casey Research founder Doug Casey millions of dollars in the stock market.

Consider…

- In 1939, Sir John Templeton made a fortune betting against the crowd.

  As you likely know, 1939 was a bad year. Millions of Americans were in poverty due to the Great Depression. And Nazi Germany had just invaded Poland to kick off World War II.

  There was an incredible amount of fear in the world. But Templeton, a recent college grad, invested $10,000 in U.S. stocks. That's the equivalent of $167,000 today.

  Amazingly, Templeton didn't even study which companies to buy. He didn't need to. He knew that the extreme fear in the world had pushed U.S. stocks down to ridiculously cheap prices. So, he simply bought any stock selling for less than $1 on the New York and American stock exchanges. That's it.

  Four years later, Templeton sold his portfolio for a 300% gain. Today, he's known as the greatest stock picker of the last century.

- In 2008, the world faced its worst economic crisis since the Great Depression.

Iconic U.S. bank Lehman Brothers failed...the biggest bankruptcy in U.S. history.

U.S. stocks crashed more than 50%...the biggest crash since the Great Depression.

And the stock prices of many great businesses dropped 80% or more.

People were terrified of losing everything: their jobs, their houses, their life savings. There was an incredible amount of fear in the markets.

But the fear was masking an incredible opportunity...

It was the best time to buy quality stocks in 30 years.

Investors who purchased quality stocks in late 2008 made a killing. For example, an investor who bought stock in coffee chain Starbucks in late 2008 has made more than 1,900% on his money. An investor who bought technology company Apple made as much as 966%. Ford Motor Company's stock gained more than 1,200% in just over two years after the financial crisis.

The list goes on. Anyone who bought any of the following companies during the financial crisis made *at least* 10 times his money in two years or less from February 2009.

» Crocs, up 1,347%

» Gulfport Energy, up 1,227%

» ION Geophysical, up 1,098%

» Ruby Tuesday, up 1,072%

» Buckeye Technologies, up 1,059%

» KapStone Paper and Packaging, up 1,036%

» SFN Group, up 1,024%

» Veeco Instruments, up 1,017%

» La-Z-Boy, up 1,016%

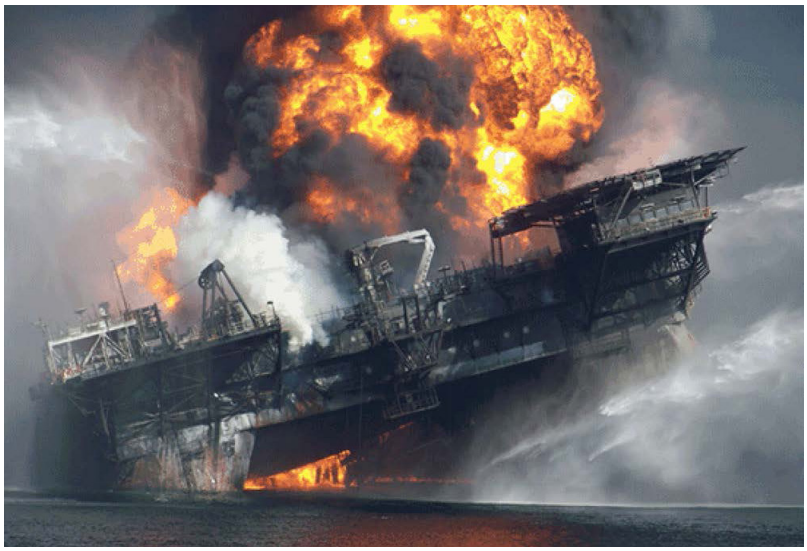
» Genworth, up 993%

» Sonic Automotive, up 906%

- In 2010, an oil rig named *Deepwater Horizon* exploded off the coast of Louisiana.

  The blast instantly killed 11 workers and eventually spilled 4 million barrels of oil into the Gulf of Mexico. It was the worst environmental disaster in U.S. history…and the biggest oil spill in world history.

The negative media coverage was nonstop. Newspapers ran pictures like this:



As partial owner of the oilrig, British oil giant BP (BP) became one of the most hated companies in the world. Investors dumped BP stock, and its share price crashed.

In a matter of weeks, BP's stock price collapsed from $59 to $27…for a stunning loss of value of ***$105 billion***.

At that point, hardly anyone would touch BP stock…but smart investors asked, "Are BP's assets really worth $105 billion less today than they were a month ago…or are investors overreacting?"

It turned out investors were overreacting. Buying BP stock near its bottom made an 80% gain in just a year. It also locked in a safe 6% (and growing) dividend yield.

BUYING WHEN BLOOD IS IN THE STREETS

Although these stories of massive wealth creation are all very different, they share a common theme.

They show the power of buying assets during times of maximum pessimism…when no one else wants to buy.

You see, from time to time, an extraordinary opportunity comes along to buy a dollar's worth of assets for a dime.

If you can spot these opportunities, you can make gigantic returns without taking big risks.

After all, the gains we just discussed didn't come from investing in speculative biotech stocks or tiny gold companies. Many of them came from just the opposite: **iconic, blue-chip American companies that have been around for decades**.

We're often told that there's a close relationship between risk and return. To earn big returns, you must take big risks, according to Wall Street.

But it's not true. Buying valuable assets for pennies on the dollar is one of the least-risky investments you can make. It's the closest there is to a "sure thing" in investing.

And you don't have to take my word for it…

In the pages that follow, I'll show you how we invest…

But first, I want to show you concrete proof that my strategy works.

I know the big gains I've talked about might sound too good to be true. To prove that I'm not cherry-picking examples of great returns, let me tell you about a recent groundbreaking study...

PROOF THAT CRISIS INVESTING CAN MAKE YOU RICH

Meb Faber is a friend of Casey Research. He's a brilliant researcher and one of the few truly original thinkers in finance.

Meb published a study about one of the most valuable ideas in finance – reversion to the mean.

Almost every investor knows that nothing goes up forever.

Sooner or later, even the mightiest bull markets get old and overvalued. Eventually, "gravity" causes the market's momentum to slow, and then reverse.

And when the market "reverts to the mean," stocks plummet.

Every investor who lived through the 1987 market crash, Russia's 1998 default, the Nasdaq decline of 2000-2002, or the mortgage meltdown of 2008 knows this. Every five to ten years, something goes horribly wrong in the market.

It's common sense.

Trees don't grow to the sky. Sooner or later, every market "reverts to the mean."

Meb's idea is based on this.

Just like stocks don't go up forever, they don't go down forever, either.

Eventually, every bear market forms a bottom. The last person left to sell actually sells. A market sinks to such an amazing level of value that investors pile in and send share prices higher.

With this in mind, Meb studied whole countries (with investable stock markets) and asset classes (types of investments) to determine if they showed any patterns.

What he found is amazing…and proof that crisis investing can make you rich.

Meb studied five major stock markets from 1903 to 2007.

He wanted to know what stock prices did on average in these markets after falling for three consecutive years.

Meb discovered that major stock markets rarely fall three years in a row. Three consecutive years of lower prices almost never happened – those instances occurred less than 3% of the time.

But when markets did fall three years in a row, the following bull market was extremely powerful.

The average return in stocks during the fourth year was **more than 30%**.

That incredible result doesn't happen by chance. It's caused by reversion to the mean.

When Meb studied asset classes, he found similar numbers.

After three years in a row of falling stock prices, the average return in the fourth year was **34%**. That's almost three times higher than the average return of all the years in the study.

Again, statistical analysis tells us these are significant results, not just chance.

The returns are proof of mean reversion in stock prices. Buying assets that are down three years in a row is a powerful market strategy.

And Meb found a way to make the results even better…

He researched the idea that mean reversion would lead to even bigger gains in stocks that had experienced major crashes.

He studied countries with stock markets that declined by 80% or more.

On average, these countries saw their indexes rebound by nearly 120% in the three years that followed.

And that's not all...

Meb studied U.S. industry groups going back to the 1920s and found the same type of huge rebounds.

When a U.S. industry group fell by 80% or more from a peak, the average return three years later was more than 170%.

These statistics are amazing…and proof that investing in depressed markets leads to gigantic returns.

It's common sense really.

When investors get extremely frustrated with an asset class, they abandon it. Prices decline to absurdly cheap levels. And just like the cycle of day and night, extreme bear markets turn into extreme bull markets.

THE WORLD'S MOST POWERFUL WEALTH-BUILDING SECRET

I believe crisis investing is the most powerful wealth-building strategy available to anyone.

Warren Buffett, Jim Rogers, and generations of Rothschilds got rich using this strategy.

And thanks to modern technology, you can implement this strategy through any ordinary brokerage account. I'm going to show you how.

Baron Rothschild was dead-on correct that "the time to buy is when blood is in the streets." Remembering and following that principle is the essence of crisis investing.

The Chinese ideogram for crisis overlays two symbols: one for danger and one for opportunity. The danger is what everybody sees. The opportunity is seldom as obvious, but if you look for it, you'll find it.

There's always a crisis – and therefore an opportunity – somewhere in the world. For investors who know how to look past the fear and survey the facts, the rewards can be life-changing.

Most investors don't realize this, but a crisis is the only time you can be sure to get assets at bargain prices. It's one of the world's greatest wealth secrets.

When investors panic, they dump stocks, bonds, and almost everything else. They stop caring about prices. They just want out. Scary news – the scarier the better – can make quality companies and superb real estate cheap for you to buy.

When any market takes a hard fall – down, say, 90% or more – take a hard look. Look past the bad news, dig through the mess, and figure out what to buy.

A crisis market invites you to buy $1 of assets for 10 cents…or sometimes just a few pennies. The worse the news, the better. We want fear and despair that skew the risk/reward ratio heavily in our favor.

Amateur investors run from crisis. Great investors run toward it. Bad news is good news. The worst news is the best of all.

When you "buy panic" in out-of-favor markets, you position yourself for huge returns.

Buying panic and investing in despair is how the Russian oligarchs *became* oligarchs. They looked through the turmoil that followed the collapse of the Soviet Union.

Some of the world's most respected investors have gotten rich with crisis investing.

- "You want to be greedy when others are fearful and fearful when others are greedy." – Warren Buffett
- "The time of maximum pessimism is the best time to buy." – John Templeton
- "As an investor, nearly always if you buy panic and you know what you are doing, and then hold on for a number of years, you are going to make a lot of money." – Jim Rogers

Where most investors saw danger, they saw opportunity. They acted on a simple premise: trouble comes and then, after a while, trouble goes.

The oligarchs bought the crown jewels of the Russian economy – massive companies involved in energy and natural resources – for literally pennies on the dollar.

This is a recurring theme in the history of wealth-building. Buy when blood is in the streets. It's all about exploiting fear, fresh memories of bad events, and politically caused distortions in the marketplace. And using the usual aberrations of mass psychology to your advantage.

If you buy when trouble comes, you'll profit when trouble goes.

Trouble isn't hard to find. But you need to have the presence of mind to look it in the eye and ask yourself just how bad it really is.

The point is…investing in crisis markets makes massive fortunes. It's when cool-headed investors seize opportunities…while others who are too timid, too poorly informed, or too short-sighted fail to recognize them.

People naturally seek the comfort of crowds. The amateur investor typically buys whatever is popular at the time. He does what everyone else is doing.

And you can't really blame him. Huddling with the crowd is how humans survived for the last 500,000 years. You were either part of the tribe or you died. But in the investment market, being part of the tribe means running with the losers.

Seeking the comfort of the crowd...buying what's popular...believing the rosy headlines. These things leave you buying expensive assets with little upside.

Now, I'm not telling you to blindly bet against the crowd. Sometimes the crowd is right.

Plenty of cheap assets deserve to be cheap. Sometimes prices fall for good reason.

The key is the ability to tell these situations apart. You need facts and a cool head to know when the crowd is overreacting to bad news…and when it is reacting appropriately.

If an investment idea makes most people, including your close friends, think you're a bit crazy, you might be on to something.

But don't buy just because the price has dropped through the floor…or just because an investment has become unpopular. Some dangers are real, and sometimes a real danger is *underestimated*.

To get it right, you need to gather the facts and weigh them coolly. When you know you've measured, weighed, and assessed the problem that has the markets worried, you'll be confident enough to buy…if that's what your calculation tells you to do.

The frightening images on TV won't scare you away from a great opportunity.

WHAT WE CAN LEARN FROM INVESTING IN CRISIS MARKETS

Let's face up to a hard question. How can you know the exact best time to buy? How can you be sure that the moment of maximum pessimism has arrived?

The hard answer: you can't. At least not until after the fact. You'll never recognize the exact bottom…except through the rearview mirror.

But you can recognize the signs that a market is near a bottom. That's good enough to make you a lot of money.

Here's what to look for.

- **Negative investor sentiment.** The mass media can be a big help here. A hot market – anything the financial media has fallen in love with – is exactly what we're *not* looking for.
- **Hated markets.** Look for bad news about a country or industry on the front page of the newspaper. The media is flashing you a signal that most investors have thrown in the towel.
- **Beaten-up markets.** When a market falls to a low not seen in a decade or more, it's worth a closer look.
- **Stocks.** Are shares in great companies dropping almost as much as shares in junk companies? This is key. In a crisis, all stocks plunge – good and bad both. Extreme negativity can compress the prices of quality companies like a coiled spring. We want to pay next to nothing for sound, productive, and well-run businesses that are earning money and paying dividends.
- **Valuation metrics.** We like markets that are at least 66% cheaper than their historical average.
- **Dividends.** Without question, dividends are the best single indicator of true value. Reported earnings can be unreliable…the right fictions can too easily pump them up. Accounting rules and stretching of the facts can distort financial statements. But a dividend payment is cash in your pocket…and you can't fake that.

While we analyze earnings, book value, and other reported market figures, we focus most on a company's dividends.

Accounting and reporting standards vary widely across the world. Dividends, on the other hand, are actual cash payments landing in your pocket. They are real, and nothing is easier to measure.

Double-digit dividend yields are a sign that sellers have panicked. They're a clue that investors have dumped shares in profitable companies. Plus, it's nice to collect a fat dividend check from a quality company while you wait for a crisis market to rebound.

It's astounding what you can get in dividends alone when a market nears its bottom.

CRISIS INVESTING AND YOUR PORTFOLIO

While crisis investing can be extremely lucrative, there are risks you need to control.

A crisis doesn't run on a schedule. It can drag on longer than expected. For example, a military clash that crushes the local stock market could turn into a long war.

That's why research and selectivity pays off. We buy quality businesses that will survive for years during a crisis. Sticking to high-quality stocks gives us a wide margin of safety.

Investing in crisis markets is a long-term value play. It takes advantage of unsustainable distortions in the market. But distortions can take time to resolve themselves. Again…they'll be running on their schedule, not yours.

Never go all-in on one single investment strategy…not even our strategy. Betting your entire life savings on any single strategy exposes you to unnecessary risk. I strongly believe everyone should allocate a portion of his portfolio to the proven strategies we use in *Crisis Investing.* But it's up to you to determine the exact amount.

That said, if you're a small investor, placing no more than $200–400 in a position is a good rule of thumb. If you're a big investor, you can increase that up to $500–1,000.

Crisis Investing focuses on investments you can easily buy and sell through any ordinary brokerage account. As long as you have a brokerage account, you can buy our recommendations with just a couple of mouse clicks.

Please, never invest money that you can't afford to lose. Losing is <u>always</u> a possibility in <u>all</u> investments, including the investments we recommend in *Crisis Investing*.

THE TOOLBOX

A good crisis investing opportunity has high potential with lower risk…not high potential plus high risk. Limiting risk is key to success. We use important tools to control risk.

The Casey Free Ride

The Casey Free Ride removes risk from an investment, but also retains significant upside. We'll often recommend you take a Casey Free Ride on an investment that has produced a large gain.

Here's how it works…

To take a Casey Free Ride, sell enough of a stock to get all of your initial investment back. Then, let the rest ride.

For example, if a stock has doubled, sell half of your position. You'll get back all the cash you invested, and you'll continue to own half of your original position. Even if the stock goes down, your initial investment will be safe.

Here's the formula:

GETTING YOUR CASEY FREE RIDE

$$\text{NUMBER OF SHARES TO SELL} = \frac{\text{PURCHASE PRICE STOCK}}{\text{STOCK PRICE WHEN YOU WANT TO SELL}} \times \text{NUMBER OF SHARES BOUGHT}$$

We often recommend taking a Casey Free Ride if a stock doubles from its buying price.

A Casey Free Ride is useful for another reason: it puts cash in your brokerage account. We're always finding new crisis investing opportunities. Taking Casey Free Rides will help you to have cash available to take advantage of the next one.

Stop Losses

Using stop losses will help us cut losses and lock in the profits of our winners.

A hard stop-loss is a predetermined price at which you will sell a stock if it declines. If shares fall below the trigger price, we will sell that stock.

A trailing stop-loss has a trigger price that rises in step with any rise in the price of the stock.

For example, let's say you set a 35% trailing stop-loss on a $10 stock. The initial stop-loss trigger price would be $6.50 (35% below $10). If the stock rises to $20, you would move your trailing stop to $13 (35% below $20). At that point, you would sell the stock if it falls to $13.

We use closing prices to determine whether a position has hit its stop loss. If a stock closes the day below its stop level, sell it the next day.

Please subtract any dividends received from the stop-loss trigger price.

Please keep track of stop-losses on stocks you own. If a stock hits its stop loss, we'll write about it in our next monthly issue. However, we will not send out a between-issues alert to remind you that a stock hit its stop-loss. It's your responsibility to monitor your portfolio and follow the stop-losses we provide.

FORTUNE FAVORS THE BOLD

It takes fortitude to look past the obvious danger of a crisis market and act on the opportunity. But that's the formula for winning big.

Investing in crisis markets can be scary. At times, you might feel like you're running into a burning building. But if you can control your emotions and buy when others are selling, you can make a fortune. After all, that's how Doug Casey, Warren Buffett, Jim Rogers, and John Templeton got rich.

Crisis Investing will bring you a perspective you won't find anywhere else – certainly not in the mainstream financial media. It looks past the headlines to report on the world's richest investment opportunities.

Detecting fear and the bargains it creates is our specialty. Each month, we write to our paid-up *Crisis Investing* subscribers about the crisis-born opportunities we've found lying in the rubble of economic collapse, civil unrest, revolution, war, and geopolitical turmoil.

Call us storm chasers. But unlike the pursuers of F5 tornadoes, we're not in it for the adrenaline. We're in it for the profit.

That's why we look for trouble. History shows the greatest opportunities for wealth-creation have happened during times of crisis.

Nick Giambruno
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